

Central Intelligence Agency



Washington, D. C. 20505

**DIRECTORATE OF INTELLIGENCE**

3 April 1984

Japan: Step-by-Step Financial Liberalization [redacted]

25X1

Summary

The Japanese have made headway on the eight financial liberalization measures jointly agreed to during President Reagan's November visit to Tokyo. Subsequent US requests for quick implementation of additional measures, however, have elicited lukewarm and sometimes hostile reactions from Tokyo. Japanese officials, including the Prime Minister, remain wedded to the step-by-step approach to financial reform that the country has followed for the past decade. We believe, nonetheless, that the mid-April meeting of the bilateral yen-dollar working group will prove more productive than the February and March meetings. [redacted]

25X1

Some Progress

The Japanese set a 1 April deadline for many of the financial measures announced in November, and most of the deadlines have been met. In some cases, however, the Ministry of Finance has blunted the intended effectiveness of the measures by issuing restrictive administrative guidance or imposing residual constraints (see table). [redacted]

25X1

Government and press reaction to US requests that the bilateral yen-dollar working group agree on concrete measures beyond the original eight-point plan has been unenthusiastic.

This memorandum was prepared by [redacted] Japan Branch, Northeast Asia Division, Office of East Asian Analysis, at the request of the National Security Council. Research was completed on 2 April 1984. Comments are welcome and should be addressed to Chief, Northeast Asia Division, OEA, [redacted]

25X1

25X1

EA M 84-10080

25X1

25X1

**JAPAN: FINANCIAL LIBERALIZATION MEASURES  
AGREED TO IN NOVEMBER 1983**

<u>Measure</u>	<u>Status</u>
Reduce minimum denomination of certificates of deposits (CDs)	Effective 1 January 1984, minimum amount lowered from 500 million yen (\$2 million) to 300 million yen. Press reports indicate further reductions possible this year. These reductions are intended to increase the attractiveness of CDs to investors and thereby improve the funding base of banks, especially foreign ones.
Eliminate real demand rule in forward exchange transactions	Ministerial ordinance modified on 22 March to permit elimination of real demand rule as of 1 April. The real demand rule prevented individuals from purchasing yen on a forward basis unless there was an underlying transaction. Japanese banks have agreed, however, to prevent certain forward transactions deemed speculative even after 1 April.
Enlarge ceilings on each bank's CD issue.	As of 1 April, quarterly ceilings on issues of CDs by Japanese banks will be raised periodically until they reach 100 percent of a bank's net worth. Foreign banks' ceilings increased from present 30 percent of total yen assets to 50 percent as of 1 April.
Ease guidelines on issue of Euroyen bonds by residents	Effective 1 April, 30 Japanese companies with net assets above 150 million yen and meeting other requirements can issue Euroyen bonds. Ninety Japanese firms will be allowed to issue convertible Euroyen bonds. Previously only selected international organizations were allowed to issue medium- and long-term Euroyen bonds, a restriction standing in the way of yen internationalization.
Submit bill to Diet to reform designated company system	{ Cabinet approved omnibus bill covering these and other external economic items on 28 February. Diet ratification still needed. The designated company system limited foreign investment in 11 specified companies, an obvious impediment to capital flows into Japan. Issuance of national bonds abroad also aims at strengthening the yen by boosting capital inflows.
Submit bill to Diet to allow issuance of foreign currency denominated national bonds abroad	
Review withholding tax on interest earnings on Euroyen bonds held by nonresidents	Little concrete progress. Finance Ministry apparently still debating budgetary ramifications and investigating how other countries handle Eurocurrency bond taxation. If the withholding tax were lifted, Euroyen bonds would be more attractive to investors and the pace of yen internationalization would accelerate.
Expedite study of establishment of bankers' acceptance market	Press reports in early March indicated the Finance Ministry and the Bank of Japan (BOJ) have agreed to establish a yen-denominated bankers' acceptance market, although the BOJ refuses to actively rediscount foreign trade bills from the market. Other press articles are pessimistic about an early start-up of this market, which many analysts view as a prerequisite to expansion of the use of yen in trade financing.

- o A February article in a leading newspaper, which reportedly echoed remarks made by Finance Ministry officials, described US demands on financial liberalization as "endless."

### Domestic Factors

Bilateral disagreements on liberalization questions can be traced primarily to differences in time horizons rather than to fundamental Japanese opposition to financial reform. Most officials in Tokyo realize domestic factors--particularly the maturing of large amounts of government bonds starting next year--make liberalization both inevitable and desirable. As these bonds approach maturity, they become, in essence, short-term, liquid investments with market-determined interest rates. As such, they are more attractive investments than time deposits at commercial banks because rates on these are kept below market-rates by government regulations. If these regulations are not abolished soon, the banks' funding capacity may be threatened.

Japanese officials favor gradual liberalization, not the rapid approach advocated by the United States during recent yen-dollar talks. They often speak in terms of liberalization over 10 years, the length of time required for deregulation of interest rates in the United States.

- o Past liberalization in Japan has been achieved incrementally. For example, a series of government directives pushed Japanese money markets from a highly regulated state in 1977 to a basically free state in 1979.
- o On liberalization to date, the International Monetary Fund has described changes in the Japanese financial system as more far-reaching than those experienced by any other country.
- o A variety of domestic factors--including opposition by the powerful postal savings system, which has deposits of \$300 billion--contribute to the Japanese belief that a step-by-step approach must be followed in deregulating interest rates on bank deposits.

- o Turf battles within the Finance Ministry and the budget bureau's desire to keep down interest payments on the national debt are also behind Japanese arguments for a go-slow approach to liberalization. [redacted]

25X1

Prime Minister Nakasone has endorsed gradual liberalization,

[redacted]

25X1

Japanese finance officials also differ with their US counterparts over the order in which liberalization of domestic capital markets and expansion of the international use of the yen should be pursued. The Japanese advocate tackling domestic problems first.

[redacted]

25X1

### Future Negotiations

The Japanese press reported that Nakasone instructed Finance Ministry officials on 28 March to draw up by mid-April a clear plan for liberalization. US concern over the lack of progress at the February and March yen-dollar talks was cited as the reason for Nakasone's ultimatum. We believe pressure from the Prime Minister and the internal timetable of the financial bureaucracy should make the 16-17 April meeting more productive.

- o In our view, Nakasone's intervention will probably persuade the Ministry to deal with yen internationalization directly instead of concentrating exclusively on domestic liberalization issues.
- o After a meeting with Nakasone, Finance Vice Minister Oba promised the Ministry would present a package at the April meeting to deregulate Euroyen bond issues by nonresidents, according to the Japanese press. [redacted]

25X1

We are less confident that the Japanese will drop their insistence on liberalizing in a step-by-step fashion.

- o If forced to make concessions that they think are too hasty or sweeping, the Finance Ministry will probably sap the measures' effectiveness either through formal restrictions or administrative guidance. [REDACTED]

25X1

**Subject: Japan: Step-by-Step Financial Liberalization**

**Distribution:**

**Original - C/OEA/NA/J**

- 1 - Donald Gregg, Office of the Vice President
- 1 - Gaston Sigur, National Security Council
- 1 - Paul Wolfowitz, Department of State
- 3 - Doug Mulholland, Treasury
- 1 - C/OEA/NA
- 1 - OEA/SEA
- 1 - OEA/CH
- 1 - D/OEAA
- 1 - OEA/Research Director
- 1 - [REDACTED]
- 1 - C/NIC
- 1 - NIO/EA
- 1 - DDI
- 1 - Executive Director
- 5 - CPAS/IMC/CB
- 2 - OCR/ISG
- 1 - C/PES/DDI

DDI/OEA/NA/J

1 - [REDACTED]  
1 - [REDACTED]

25X1

3 April 1984

25X1